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In the Supreme Court of the United States

OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
PETITIONER,

v.

INVESTMENT COMPANY INSTITUTE,
RESPONDENT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MEMORANDUM OF THE AMERICAN BANKERS ASSOCIATION AS *AMICUS CURIAE*

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The American Bankers Association, with the consent of the parties, submits this memorandum *amicus curiae* in support of the petition for a writ of certiorari.

INTEREST OF THE AMERICAN BANKERS ASSOCIATION

The American Bankers Association ("ABA") is the principal trade association of the commercial banking industry. The ABA represents approximately 14,300 banks of all sizes, or 94 percent of all commercial banks in the United States,

including banks in each of the fifty states and the District of Columbia. The ABA and its member banks have an obvious interest in this case, which presents an important question concerning the proper relationship between two major federal banking statutes.

ARGUMENT

1. *This case raises an important question of federal law that should be settled by this Court.* The court of appeals below incorrectly decided an issue of major importance to the banking industry, and in doing so it has injected substantial uncertainty into the administration of both the Glass-Steagall Act[1] and the Bank Holding Company Act, as amended, 12 U.S.C. §§ 1841 *et seq.*

The court of appeals in this case held that the Board of Governors of the Federal Reserve System exceeded its statutory authority by determining that sponsoring, organizing, or controlling (hereinafter collectively referred to as "sponsoring") a closed-end investment company[2] is "closely related to banking" within the meaning of section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8). This decision is of course a matter of direct concern to all bank holding companies that now sponsor closed-end investment companies or might in the future desire to do so. But

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[1] The Glass-Steagall Act, which was enacted as part of the Banking Act of 1933, 48 Stat. 162, is codified at various places throughout 12 U.S.C.

[2] "[A] closed-end investment company typically does not issue shares after its initial organization except at infrequent intervals and does not stand ready to redeem its shares." 12 C.F.R. § 225.125(c). In contrast, an open-end investment company, or mutual fund, "is continuously engaged in the issuance of its shares and stands ready at any time to redeem the securities as to which it is the issuer." *Id.*

the opinion below also has much wider implications for the banking community at large. The apparent rationale of the court of appeals, that the "policies" of the Glass-Steagall Act bar national banks and bank holding companies alike from undertaking any of an inadequately delineated category of "securities activities," *e.g.*, Pet. App. A, p. 44a, is a matter of grave and general concern. This broad-brush approach to the carefully constructed statutory scheme governing the banking industry has needlessly cast a shadow over a broad spectrum of services that historically have constituted a significant part of the business of many banks of all sizes, including especially customary investment management and advisory services.

By substituting an appeal to the general "policies" of the Glass-Steagall Act in place of a close analysis of the statutory language, and by shunning altogether any analysis of the factors that traditionally have been considered relevant to a determination of whether activities are "closely related to banking," the court of appeals has withdrawn from the Board an indeterminate, but potentially substantial, portion of the regulatory authority that Congress intended the Board to exercise. The decision below thus leaves in its wake an unsettled regulatory climate, in which the Board cannot readily determine the scope of its legal authority and the banking industry consequently cannot be certain of its rights and responsibilities.

In short, this case presents an important question not only for bank holding companies but also for the Board and the banking industry generally. This Court should review the case in order to clarify the meaning and proper application of the Glass-Steagall and Bank Holding Company Acts and thereby dispel the confusion and uncertainty that have been engendered by the decision below.

2. *The judgment below is in error and should be reversed.* The decision of the court of appeals was wrong both in its analysis and in its result. The Glass-Steagall Act does not bar

a bank holding company from sponsoring a closed-end investment company, and the Board, in determining that such sponsorship is "closely related to banking," correctly weighed the factors pertinent under section 4(c)(8) of the Bank Holding Company Act. That determination therefore should have been sustained.

a. In the court below, the Investment Company Institute, respondent here, argued only that sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. §§ 24 (Seventh) and 378, barred bank holding companies from sponsoring closed-end investment companies. As the court of appeals correctly pointed out, however, those provisions do not even apply to bank holding companies. Indeed, the court of appeals itself did not rely upon any provision of the Glass-Steagall Act as prohibiting bank holding companies from sponsoring closed-end investment companies. Instead, the court rested its decision upon the sheer speculation that Congress, although it "may have been mistaken in its perception," Pet. App. A, p. 44a, nevertheless "probably believed," *id.* at 38a, that former section 19(e) of the Act, 48 Stat. 188, *repealed,* 80 Stat. 242-43, had barred such activity.

The court misread and misapplied the legislative history. There is absolutely nothing in that history that supports the proposition that Congress, either when it enacted section 19(e) or later, intended or understood that that statute related in any way to the sponsorship of closed-end investment companies. Even more significant than the court's misreading of the legislative history, however, is its fundamental analytical error in failing to "begin with the language of the statute itself." *Transamerica Mortgage Advisors* v. *Lewis,* 48 U.S.L.W. 4001, 4002 (Nov. 13, 1979). An analysis of the specific statutory text, which the court of appeals unaccountably failed to undertake, demonstrates that section 19(e) did not, and its present-day successor, section

20, 12 U.S.C. § 377,[3] does not, prohibit the sponsorship of closed-end investment companies.

Section 19(e) was not a prohibition on business activity at all. It simply imposed a restraint on the ability of a parent corporation to vote the shares of a banking subsidiary when the parent also had an interest in a company "formed for the purpose of, or engaged principally in, the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities . . . ." *See Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 243-44 (1978). Only in 1966, long after the enactment of the Bank Holding Company Act, was the Glass-Steagall Act amended to state an outright prohibition in this regard. At that time, section 19(e) was repealed and the coverage of section 20 expanded so as to bar the parent bank holding company from owning a controlling interest in a corporation engaged principally in activities of the kind formerly described in section 19(e). 80 Stat. 242-43.[4]

Section 20 of the Glass-Steagall Act, even as so amended, plainly does not preclude a bank holding company from sponsoring a closed-end investment company. Such an investment company performs solely fiduciary services: unlike an investment banking or brokerage firm, a closed-end investment company does not issue, distribute, or underwrite securities as a means of producing income; unlike a mutual

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[3] The court of appeals, "needless to say, ...intimate[d] no views as to the applicability to the present case of sections 20 and 32." Pet. App. A, p. 44a. Section 32 of the Glass-Steagall Act, 12 U.S.C. § 78, bars certain interlocking directorships and in fact appears to have no applicability here. Section 20, however, is the principal provision of the Glass-Steagall Act relating to bank holding companies.

[4] The coverage of section 20 was enlarged by an amendment to the definition of "affiliate" in section 2(b). See 80 Stat. 242.

fund, it is not engaged in the continuous issuance, sale, and distribution of its own shares. See note 2, *supra.*

Certainly a closed-end investment company is not "engaged principally in" issuing, underwriting, or distributing securities merely because, like any business corporation, it issues shares to acquire initial capital at the outset of business operations. *Cf. Board of Governors* v. *Agnew,* 329 U.S. 441, 446-49 (1947). Such an investment company is formed for the purpose of managing an investment portfolio as a fiduciary on behalf of its public owners, and it is "engaged principally in" that activity. In any event, the Board has permitted sponsorship only of closed-end investment companies that "are *not* primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. § 225.125(f) (emphasis added). Accordingly, the Board's determination that such sponsorship is "closely related to banking" plainly does not contravene the prohibition of section 20.

b. Since the Glass-Steagall Act did not and does not prohibit a bank holding company from sponsoring a closed-end investment company, the Board had statutory authority to decide in the first instance whether such sponsorship was to be allowed under the Bank Holding Company Act. Section 4(a) of the Bank Holding Company Act generally bars bank holding companies from owning or controlling subsidiaries engaged in nonbanking activities. But in section 4(c)(8) of that Act, Congress has granted the Board broad legislative power to exempt from that prohibition activities that the Board determines to be "so closely related to banking . . . as to be a proper incident thereto."[5] In determining that the

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[5] The broad prohibition against ownership in section 4(a) of the Bank Holding Company Act meant that the narrower prohibition against the voting of shares in section 19(e) of the Glass-Steagall Act no longer served any substantial purpose. It was for this reason that section 19(e) was repealed. *See* S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966). But by simultaneously enlarging the coverage of section 20 of

sponsorship of closed-end investment companies is "closely related to banking," and therefore permissible to bank holding companies, the Board acted well within its power under section 4(c)(8).

In making a determination under section 4(c)(8), the Board is required to examine the precise nature of the activities in question and the relationship or connection between those activities and banking activities. *See, e.g., Association of Bank Travel Bureaus* v. *Board of Governors,* 568 F.2d 549, 551-52 (7th Cir. 1978). The Board followed this approach here. The Board found that sponsoring, organizing, or controlling a closed-end investment company was similar or functionally related to the investment-advisory services traditionally performed by banks. See, *e.g.*, Pet. App. D, pp. 61a-63a. The determination that such sponsorship is "closely related to banking" was guided by the Board's thorough understanding of "matters relating to the banking industry structure and operations, areas in which the Board may be presumed to have expertise." *Alabama Ass'n of Insurance Agents* v. *Board of Governors,* 533 F.2d 224, 246 (5th Cir. 1976), *modified,* 558 F.2d 729 (1977), *cert. denied,* 435 U.S. 904 (1978). The Board's determination therefore was entitled to substantial deference and should have been sustained by the court of appeals. *See Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. at 254; *National Courier Ass'n* v. *Board of Governors,* 516 F.2d 1229, 1237 (D.C. Cir. 1975).

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the Glass-Steagall Act, Congress placed an implicit restriction on the Board's power under section 4(c)(8) of the Bank Holding Company Act: the Board may not authorize what section 20 prohibits. Conversely, however, the Board is free to consider the authorization of activities not barred by section 20.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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